# The Voting Premium

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# Shareholder voting

- Voting is a key mechanism of corporate governance:

  - elect directors; approve major corporate transactions; decide on ESG policies

- Empirical literature documents voting premium:

  - five methods, e.g.: dual-class premium: 24%; block trading: 42%

- Key explanation is through takeovers and contests for control

  - Grossman, Hart 1988; Harris, Raviv 1988; Zingales 1995; Bergström, Rydqvist 1992; Rydqvist 1996

# The voting premium

But questions remain:

- ❑ Voting premium appears to be largest in economies where firms are well-protected against takeovers and control contests hardly ever take place (e.g., Dittman 2004)

- ❑ Voting premium remains positive, even with „coattail" provisions (Smith and Amoako-Adu 1995; Nenova, 2003)

- ❑ Voting premium is largest around shareholder meetings compared to other periods of the year (e.g., Kalay, Karakas, Pant 2014; Kind, Poltera 2013)
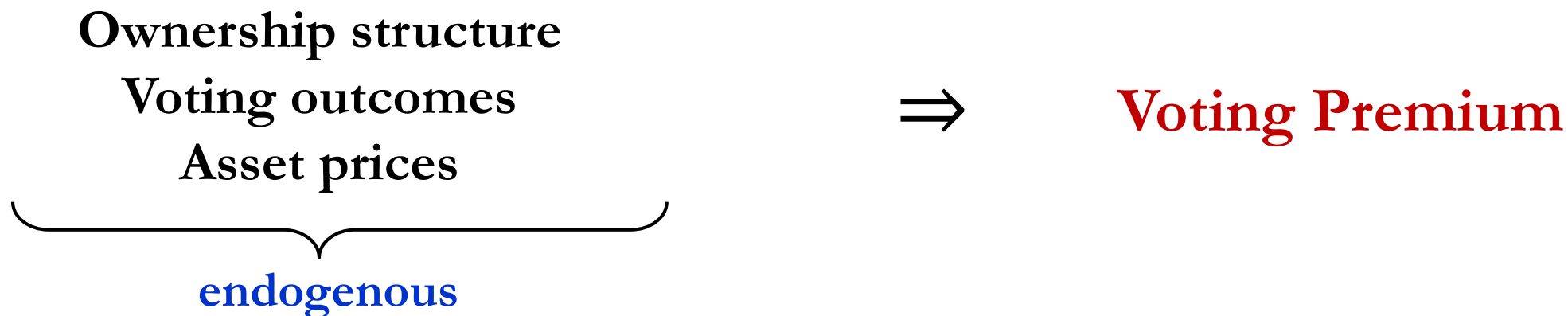
# What we do

**Unified theory of blockholder governance & voting premium**

- No control contests, no takeovers

- Minority **blockholders** and **dispersed** shareholders

  - Minority blockholders are common, often exercise power through voting

  - La Porta et al. 1999; Edmans and Holderness 2017; Dasgupta et al. 2020; McCahery et al. 2016

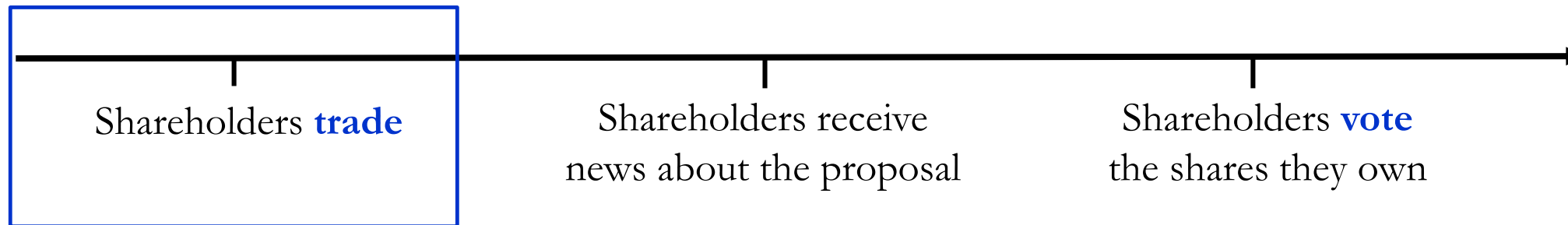- Shareholders **trade** and then **vote**

# What we do

**Unified theory of blockholder governance & voting premium**

- No control contests, no takeovers

- Minority **blockholders** and **dispersed** shareholders

- Shareholders **trade** and then **vote**

**Ownership structure**
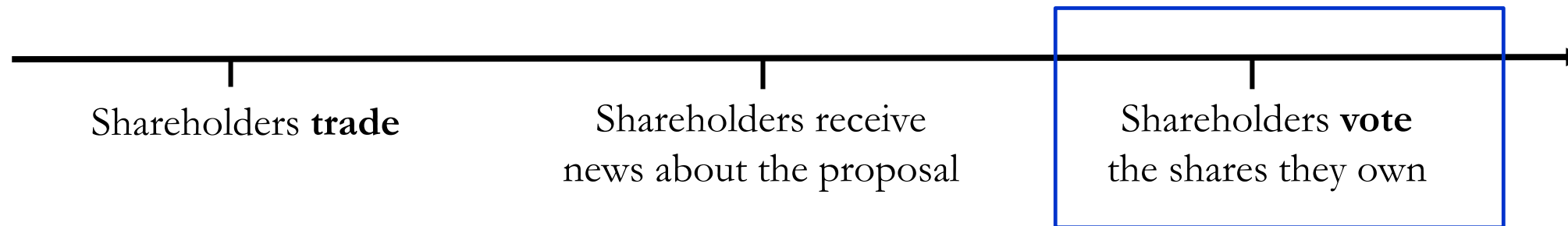**Voting outcomes**
**Asset prices**
$\Rightarrow$ **Voting Premium**

**endogenous**

# Model: Timeline

Shareholders **trade**      Shareholders receive      Shareholders **vote**
news about the proposal      the shares they own

- One class of shares; competitive market

- Blockholder **(B)** and dispersed shareholders (**SH**) trade
  - B: endowment $\alpha$; trades $y$
  - SH: endowment $1 - \alpha$; trade $x$ (price takers)

- B never becomes a controlling shareholder
- Extension to multiple blockholders

# Model: Timeline



Shareholders **trade**

Shareholders receive
news about the proposal

Shareholders **vote**
the shares they own
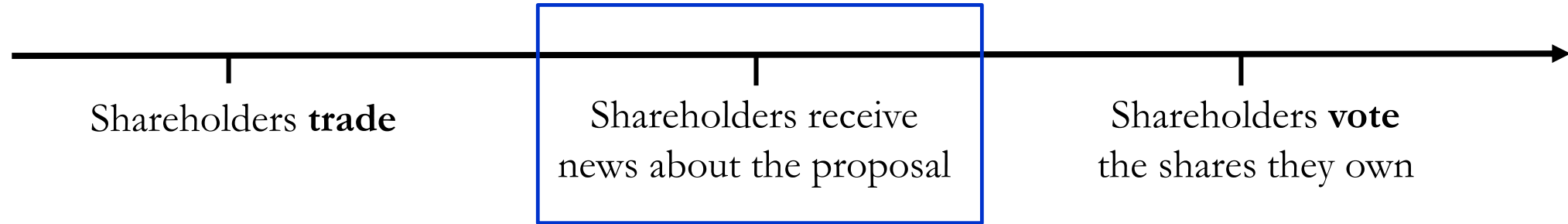
- Public signal *q* about proposal quality

  ❑ disclosure by management

  ❑ recommendations of proxy advisors

# Model: Timeline

| | | |
|---|---|---|
| Shareholders **trade** | Shareholders receive news about the proposal | Shareholders **vote** the shares they own |

- Voting on a proposal:
  - M&A, proxy fight, ESG issues, etc.
  - endogenous voter base

- Shareholders have **heterogeneous preferences** regarding the proposal
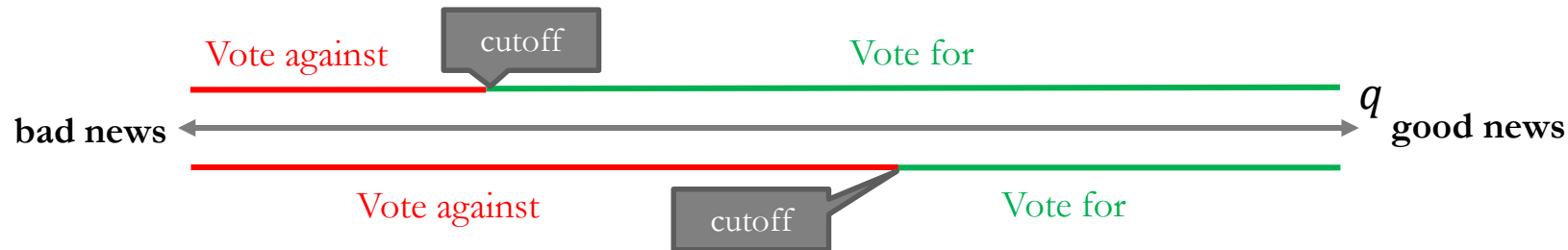  - "biases" $b$

# Heterogeneity of preferences

It is simply not true that the "preferences of [shareholders] are likely to be similar" (Martin and Partnoy 2005)

- **Governance philosophy**: Bubb, Catan 2020
- **Social/political ideology**: Bolton et al. 2020
- **Time horizon**: Bushee 1998; Gaspar, Massa, Matos 2005
- **Tax differences**: Desai, Jin 2011
- **Cross-ownership**: He, Huang, Zhao 2019
- **Conflicts of interest**: Cvijanovic, Dasgupta, Zachariadis 2016
- **Private benefits**: e.g., unions; family shareholders and founders
- **Differences of opinion**: Li, Maug, Schwartz-Ziv 2021

# Shareholders' voting decisions

- Shareholder with bias $b$ votes in favor if $q + b > 0$

- Large $b \Rightarrow$ like the proposal
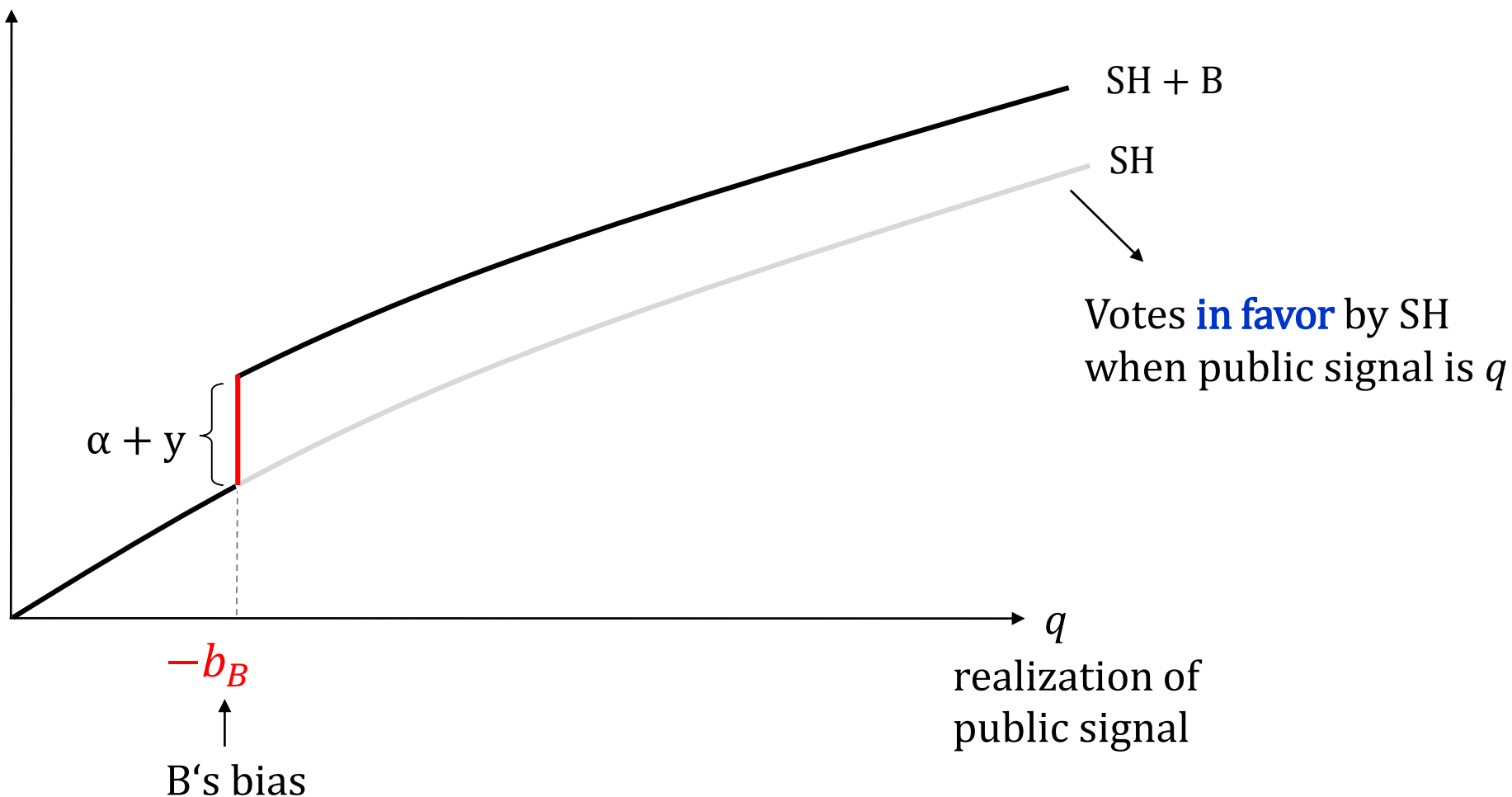  - ❑ require little evidence to vote for proposal $\Rightarrow$ **low cutoff** on $q$

Vote against    cutoff        Vote for

**bad news** $\longleftrightarrow$ $q$ **good news**

Vote against        cutoff        Vote for

- Small $b \Rightarrow$ dislike the proposal
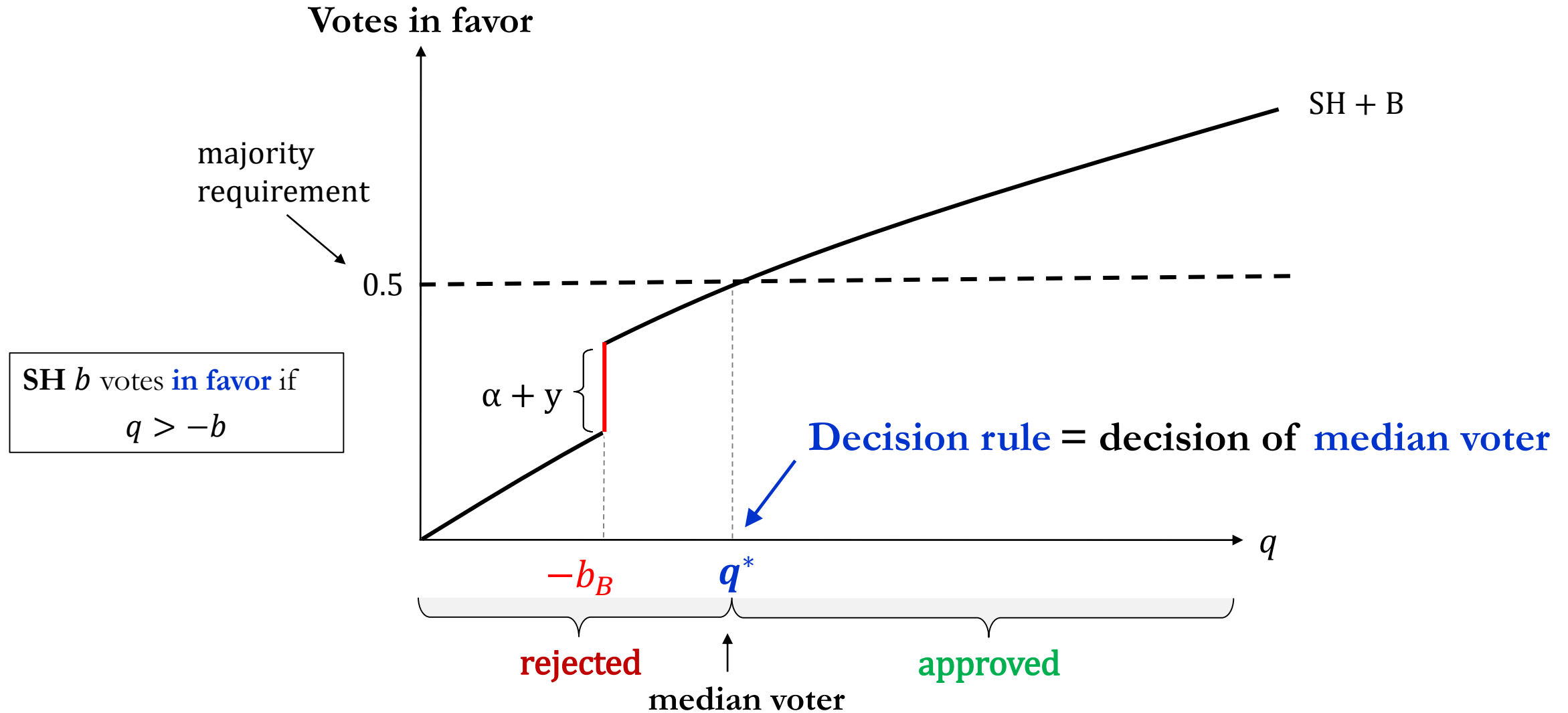  - ❑ require a lot of evidence to vote for the proposal $\Rightarrow$ **high cutoff** on $q$
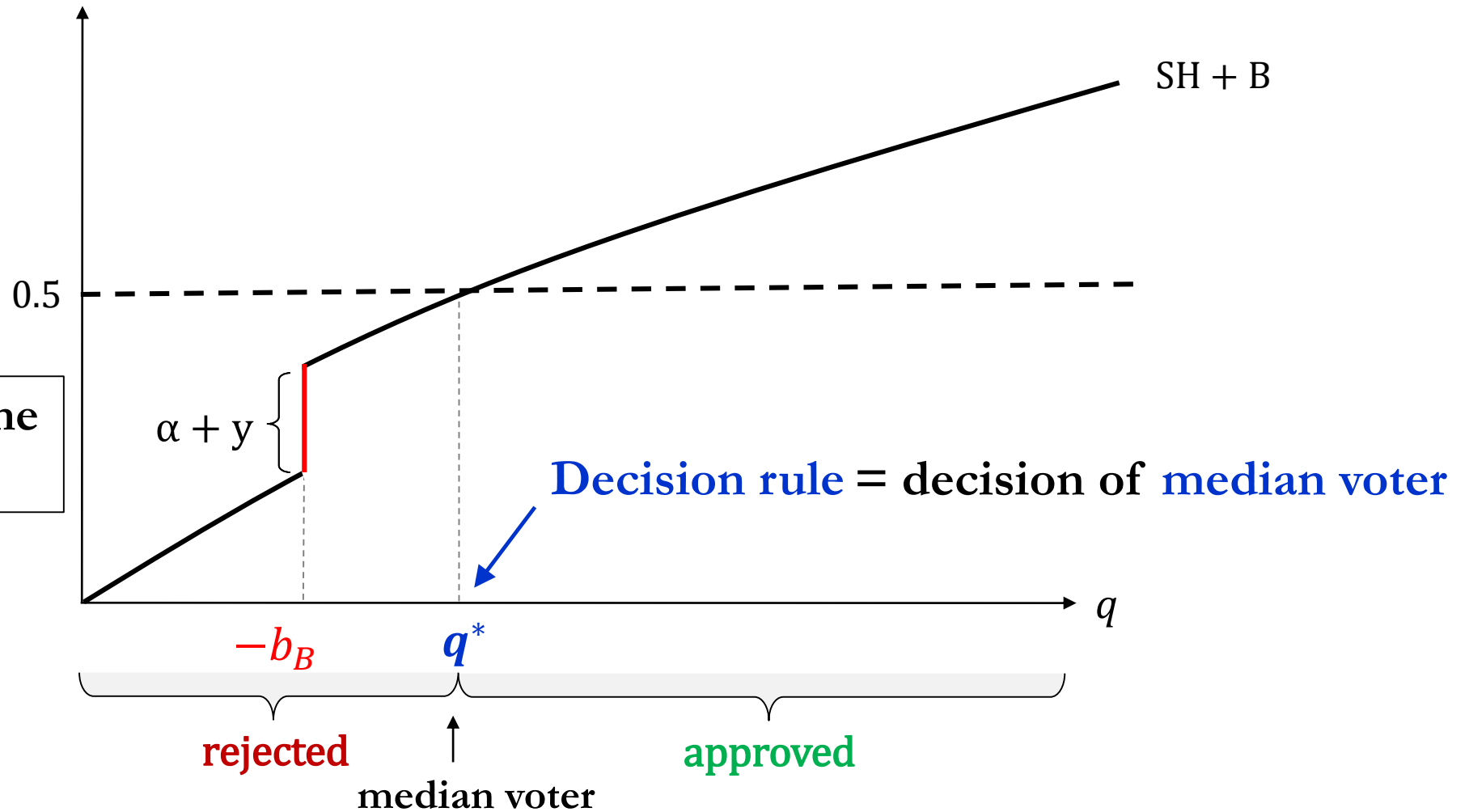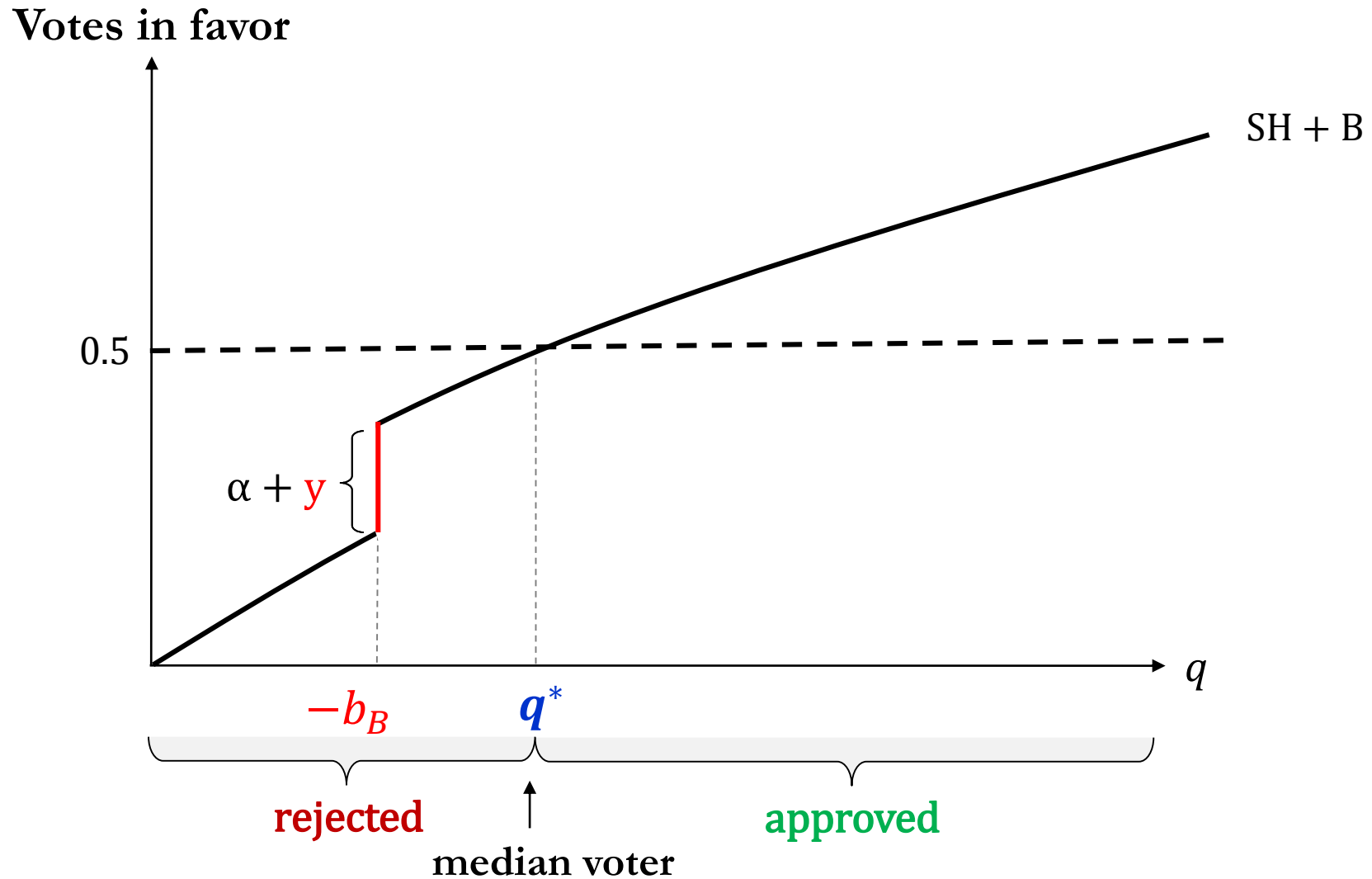
# Voting

Votes in favor

SH + B

SH

Votes **in favor** by SH
when public signal is $q$

**SH** $b$ votes **in favor** if
$$q > -b$$

$\alpha + y$

$-b_B$

$q$
realization of
public signal

B's bias

# Voting



**Votes in favor**

majority
requirement

0.5

SH + B

$\alpha + y$

**SH** $b$ votes **in favor** if
$$q > -b$$

**Decision rule** = decision of **median voter**

$-b_B$

$q^*$

rejected

approved

median voter

$q$

12

# Voting

Votes in favor

SH + B

0.5

$\alpha + y$

B is generally not the median voter

Decision is not aligned with B's preferences

Decision rule = decision of median voter
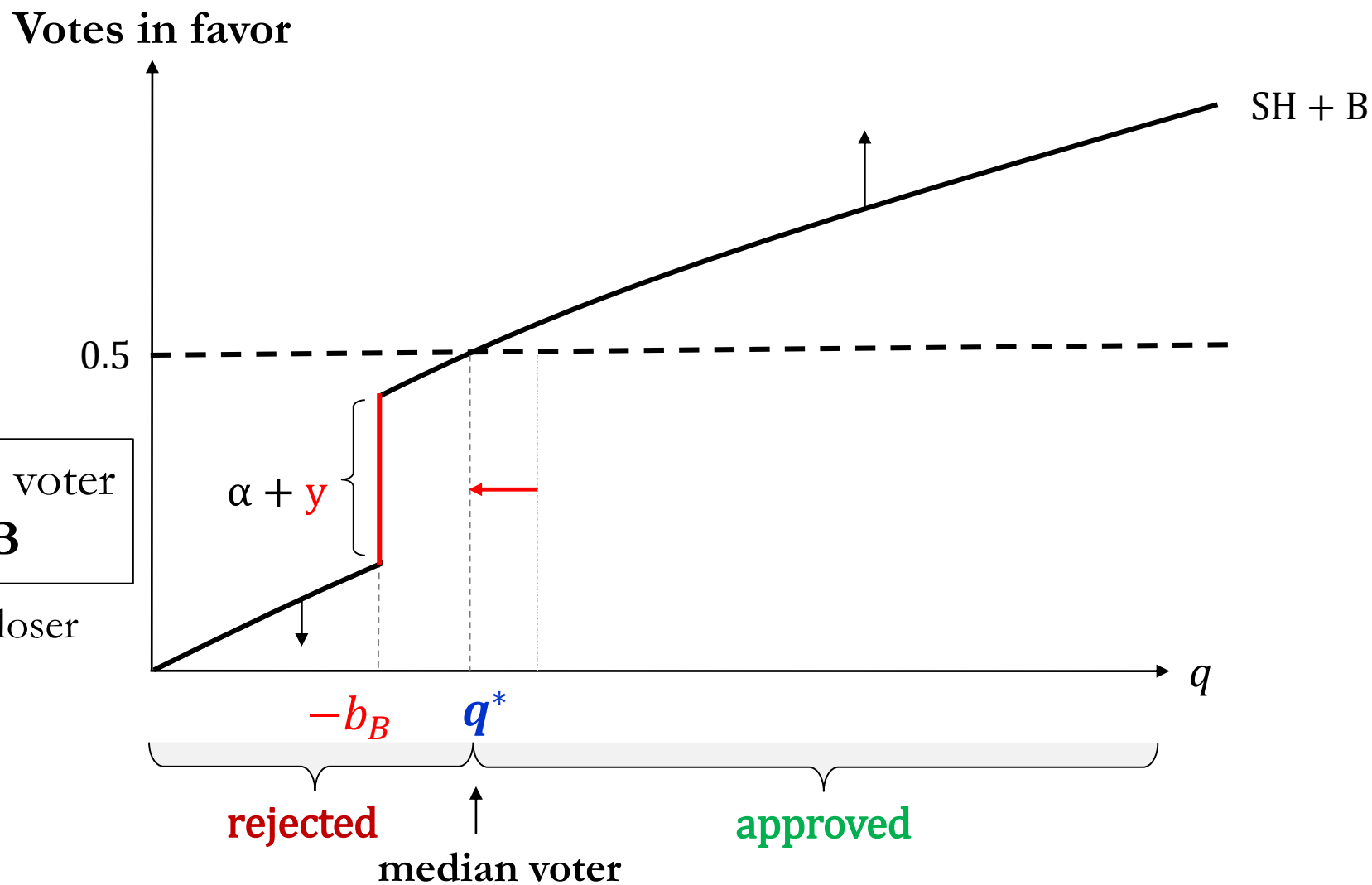
$q$

$-b_B$

$q^*$

rejected

approved

median voter

# B's trades affect the voting outcome

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Votes in favor

SH + B

0.5

$\alpha + y$
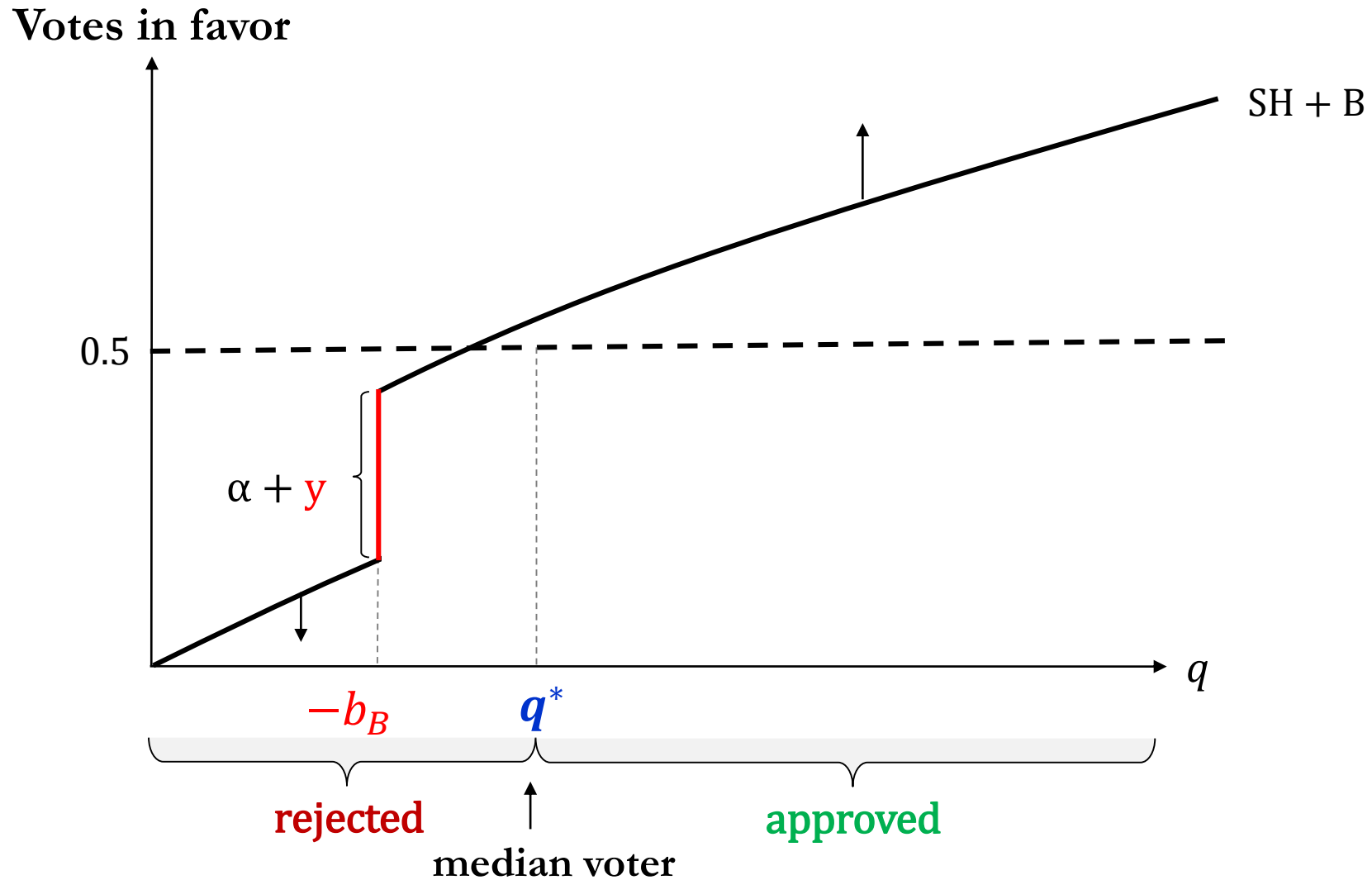
B buys ⇒ median voter moves **closer to B**

Decision becomes closer to B's preferences

$-b_B$     $q^*$

$q$

rejected     approved

median voter

# B's trades affect the voting outcome

# B's trades affect the voting outcome



Votes in favor

SH + B

0.5

$\alpha +$ **y**

Further buying doesn't affect the median voter

(although B holds <50%)

$-b_B = q^*$

rejected

approved

median voter

$q$

# Trading



Shareholders **trade** | Shareholders receive news about the proposal | Shareholders **vote** the shares they own

**Motives for trade:**

1. Both SH and B have a cash flow motive to trade:

   - Heterogeneous preferences $\Rightarrow$ different valuations $v(b, q^*)$
   - Proposal is more likely to be accepted $\rightarrow$ shareholders who like it will buy more

2. B also has a **voting motive**: B's buying moves median voter $q^*$ closer to B: $q^*(y)$

3. Price is determined by market clearing

# Blockholder's trading

**B's payoff:**

$$\Pi = \underbrace{(\alpha + \textcolor{red}{y})v(b_B, q^*)}_{\text{Value of B's stake}} - \underbrace{\textcolor{red}{y}p(\textcolor{red}{y}, q^*)}_{\text{Stock price}} - \text{trading costs}$$

B's stake   B's valuation

Net value of moving median voter $q^*$

Effect of B's trades on median voter $q^*$

$$\frac{d\Pi}{dy} = \frac{\partial\Pi}{\partial y} + \boxed{\frac{\partial\Pi}{\partial q^*}\frac{\partial q^*}{\partial y}}$$
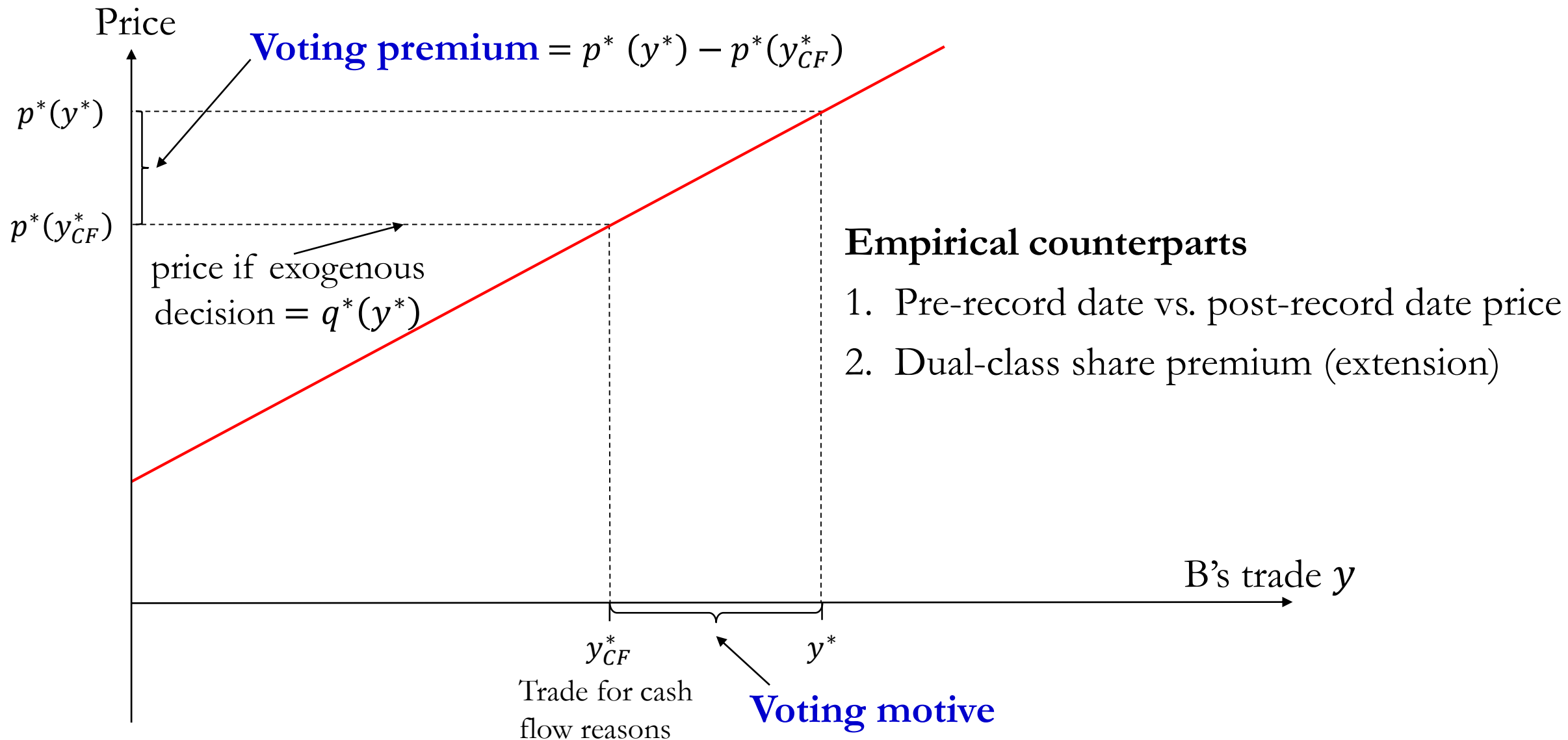
**Cash flow motive:** $y^*_{CF}$

**Voting motive:** $y^*$

# Share price and voting premium

Price

**Voting premium** $= p^*(y^*) - p^*(y_{CF}^*)$

$p^*(y^*)$

$p^*(y_{CF}^*)$

price if exogenous decision $= q^*(y^*)$

**Empirical counterparts**

1. Pre-record date vs. post-record date price

2. Dual-class share premium (extension)

B's trade $y$

$y_{CF}^*$

Trade for cash flow reasons

$y^*$

**Voting motive**

# Implication #1

**The voting premium underestimates the value of voting rights**

If B is median voter $\Rightarrow$ voting premium $= 0$

$$\frac{d\Pi}{dy} = \frac{\partial\Pi}{\partial y} + \frac{\partial\Pi}{\partial q^*}\boxed{\frac{\partial q^*}{\partial y}} = \mathbf{0} \text{ if } \mathbf{B} \text{ is median voter}$$

**Cash flow motive**　　　　　**Voting motive**

- Voting outcome **is** affected by B's accumulation of votes: $q^*(y^*) \neq q^*(0)$

- Voting premium reflects **marginal** not th **total** value of voting rights

# Implication #2

**SH's average payoff can increase with the voting premium**

- Literature: Voting premium measures extraction of "private benefits"
- Our model: What happens if B moves away from average SH and from MV?



- Voting premium increases: more activist B has larger benefits from moving MV
- SH's payoff increases too: more activist B moves MV toward average SH

# Implication #3

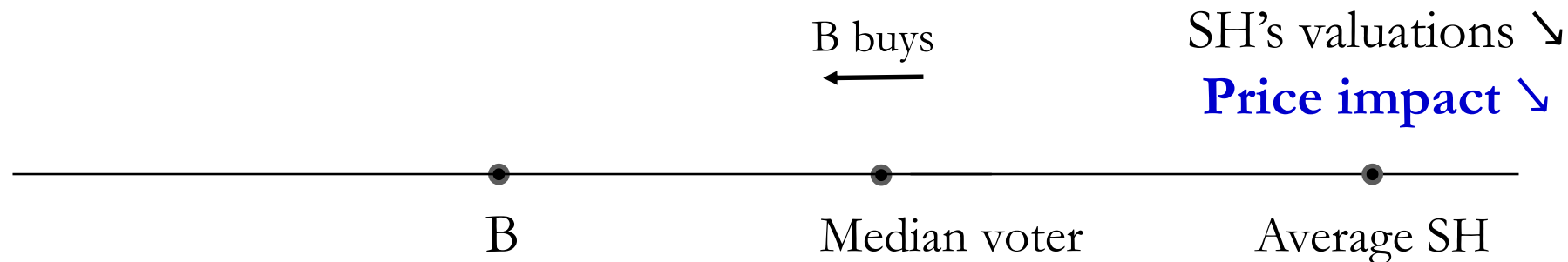## Liquidity (price impact) is endogenous

- As B buys and moves median voter, SH's valuations change

SH's valuations ↗
**Price impact ↗**

B buys
←

●——————————●——————————●————————————
Average SH          B          Median voter
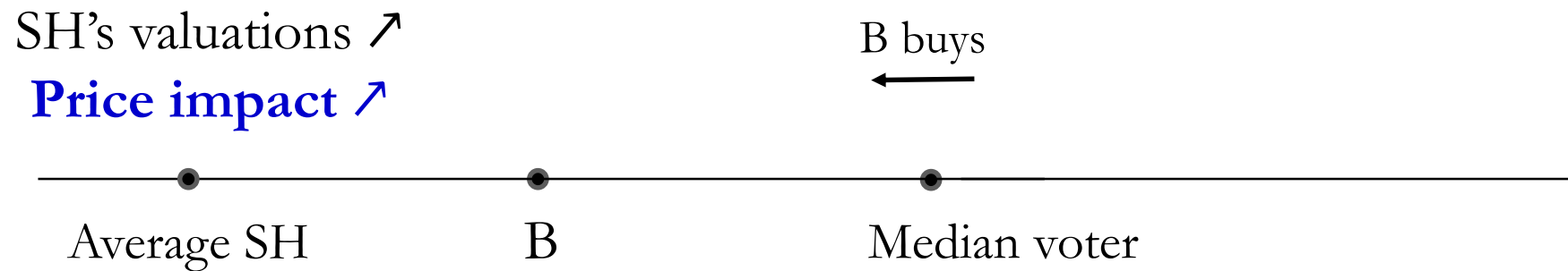
# Implication #3

## Liquidity (price impact) is endogenous

- As B buys and moves median voter, SH's valuations change



⇒ Liquidity of voting and non-voting shares differs
- which is more liquid depends on conflict/alignment of interests
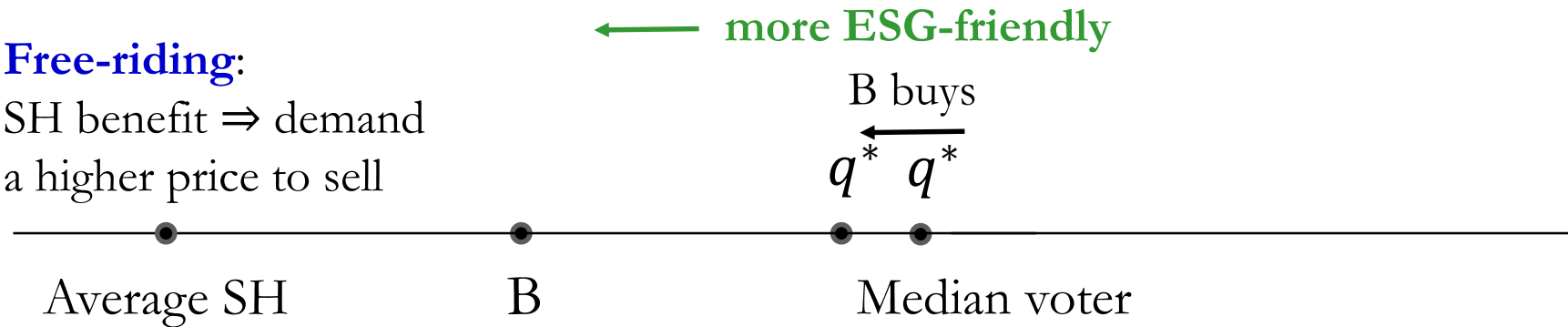
# Implication #4

## Negative voting premium

(e.g., Nenova 2003; Caprio and Croci 2008; Ødegaard 2007)

- B and SH both like ESG-friendly policies, SH like them even **more** than B



- If B buys, price (SH's value) increases more than B's own value

$\Rightarrow$ value of control becomes **negative** from free-riding ($y^* < y^*_{CF}$)

# Implication #5

**Voting premium does not emerge from voting power, but from B's indirect influence on the voting outcome**

- B's trades affect voting outcome by affecting the shareholder base and **moving the median voter $q^*$**

- Consider two scenarios

  - B is small $\rightarrow$ pays for additional influence $\rightarrow$ **positive** voting premium
  - B is large $\rightarrow$ cannot buy additional influence $\rightarrow$ **no** voting premium
  - Voting premium **negatively** related to B's voting power!

# Other implications

- **Market for votes**
  - price of vote traded separately $\neq$ price of vote bundled with cash flow rights

- **Multiple blockholders**

- **Exit vs. voice**

- **Block premium**

# Interpreting the empirical evidence

| Methodology | Avg. (%) | Number of studies |
|---|---|---|
| Dual-class shares | 23.59 | 23 |
| Block-trade premium | 41.50 | 9 |
| Option replication | 0.20 | 5 |
| Equity lending | 0.01 | 2 |
| Record-day trading | 0.09 | 1 |

- Reinterpretation of existing empirical measures of the voting premium
  - Marginal vs. average value of a vote
  - Separating votes vs. separating cash flows
  - Several studies report a **negative** voting premium

# Conclusion

## Theory of blockholder governance and voting premium

- Asset pricing implications of blockholder governance:
    - Voting premium measures the value of a marginal vote, not "voting power"
    - Arises without contests for control
    - Depends on alignment of interests
    - Voting premium not related to „private benefits"